

**UNIVERSITY OF SOUTHERN QUEENSLAND**

**EARNINGS MANAGEMENT PRACTICES  
AND SUBSEQUENT FIRM PERFORMANCE  
OF COMPANIES LISTING ON THE KUWAIT  
STOCK EXCHANGE (KSE)**

A Dissertation submitted by

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# Abstract

The earnings management around listing phenomenon has been widely discussed in the literature—with conflicting results. However, research surrounding this issue is underdeveloped in relation to the Kuwaiti capital market. Motivated by the lack of research on this issue and the unique combination of listing requirements in the Kuwaiti setting, this study first examines how Kuwaiti Closed Shareholding Companies (KSCCs) manage their pre-listing earnings. Second, it explores whether auditors with a high reputation restrict opportunistic earnings management. Third, it examines the occurrence of earnings management behaviour around the first lockup expiration period. Finally, it seeks to explore the association between pre-listing year earnings management and subsequent firm performance.

The sample firms used in this study (68 KSCCs) consists of all KSCCs listing on the KSE from 1997 through to 2007 excluding banks and regulated industries. Five hypotheses were developed to address the study objectives and research sub-questions. For hypotheses testing purposes, the sample was, on occasion, split into different groups and study periods. Testing these hypotheses involve comparing the pre-listing, listing and post-listing year earnings management. Earnings management and auditor reputation, profit requirement change and lockup restrictions are also examined; and the association between earnings management and post-listing performance is investigated. Aggregate accruals are used to estimate earnings management. Six cross-sectional models were chosen for this study to estimate discretionary accruals: three models are based on total accruals and three models are based on current accruals.

Several conclusions can be drawn from the results. With respect to the pre-listing year earnings management, there is some evidence to support the existence of opportunistic earnings management exercised by KSCC issuers in the pre-listing financial year when using current accruals models. However, a significant result was not found when models based on total accruals were used.

The examination of the lockup restriction—mandated by law in the Kuwaiti market—has an interesting implication. This research finds that KSCCs issuers opportunistically advanced total accruals in an attempt to improve earnings during the first lockup expiration period. Additionally, firms which listed after the lockup restrictions were imposed exhibited a significant level of post-listing earnings management compared to firms that listed before the lockup restrictions were imposed. As a result, evidence exists that KSCC issuers used current accruals to manage pre-listing earnings to be able to list on the KSE. Meanwhile, they used total accruals to manage post-listing year earnings to gain wealth from selling the highest portion of their restricted shares at the highest price possible.

Results obtained from testing post-listing stock and accounting performance are inconsistent. Results from testing the stock return performance using BHARs and CARs for all KSCCs sample firms support the managerial opportunism explanation and the existence of a negative association between DCA in the pre-listing year and post-listing stock performance. In contrast, testing accounting performance shows insignificant results. Results from testing the accounting performance using ROA reveals that KSCCs sample firms exhibit a significant subsequent decline in the adjusted-median ROA and in the raw-median ROA in the second post-year period, but not in the other years. However, when the sample firms are split into groups

based on their levels of DCA, result suggests no significant differences observed in the adjusted-median ROA and in the raw-median ROA between groups.

The findings make a number of contributions to the international earnings management literature, Kuwaiti financial market's policy and practice, and Kuwaiti investors. First, this research provides the first known empirical evidence based on the analysis of earnings management behaviour related to close shareholding companies around listing, which represent 90% of companies listed on the KSE in the emerging market, Kuwait. Second, the evolution of the listing requirements imposed by the KSE on the KSCCs in Kuwait between the years 1984 to 2010 for both the official market and the parallel market are documented. Third, the study results are important to investors for improving their decision-making processes and indicate that caution should be exercised when investing in newly-issued firms. Fourth, examination of the lockup restrictions highlight the agency conflict that exists between the agent (KSCCs issuers) and principal (investors) around lockups and alerts Kuwaiti regulators to consider reviewing listing requirements and possibly reassess them in light of these results. Finally, the results also indicate that investors should not interpret the use of high reputation auditors as an indication of reliable financial statements.

# Certification of Dissertation

I certify that the ideas, experimental work, results, analyses, software and conclusions reported in this dissertation are entirely my own effort, except where otherwise acknowledged. I also certify that the work is original and has not been previously submitted for any other award, except where otherwise acknowledged.

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Signature of Candidate

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Date

## ENDORSEMENT

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Signature of Supervisor/s

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Date

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## **Publications arising from this dissertation**

1. Algharaballi, E. 2012, 'Listing year discretionary accruals by Kuwaiti Shareholding Companies (KSCCs)', paper presented to the International Conference on Social Sciences, Management, Biotechnology & Environment Engineering, Dubai 7-8 January.
2. Algharaballi, E. and Goyen, M. 2012, 'Corporate reporting, security regulation and trading on the Kuwait Stock Exchange (KSE)-institutional implications for research', Journal of Governance and Regulation vol.1, no. 2, PP. 7-23. Contributions made by authors are 75% and 25% respectively.

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# List of Abbreviations

BHARs	Buy and Hold Abnormal Returns
CA	Current Assets
CARs	Cumulative Abnormal Returns
CBK	Central Bank of Kuwait
CFO	Cash Flow from Operations
CL	Current Liabilities
COGS	Cost of Goods Sold
DA	Discretionary Accruals
DCA	Discretionary Current Accruals
DEP	Depreciation
EBXI	Earnings Before Extraordinary Items
EMH	Efficient Market Hypothesis
GAAP	Generally Accepted Accounting Principals
GCC	Gulf Corporation Council
GGI	General Global Index
GII	Global Industry Index
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IMF	The International Monetary Fund
IOSCO	International Organization of Securities Commission
IPOs	Initial Public Offerings
KAAA	Kuwait Accountants and Auditors Association
KATS	Kuwait Automated Trading System
KCC	Kuwait Clearing Company
KSCs	Kuwaiti Public Shareholding Companies
KSCCs	Kuwaiti Closed Shareholding Companies
KSE	Kuwait Stock Exchange
MC	Market Committee
MoCI	Ministry of Commerce and Industry
MTC	Mobile Telecommunication Company
NDA	Non-Discretionary Accruals
OTC	Over-the-Counter
PPE	Property Plant and Equipment
REV	Revenues
ROA	Return on Assets
ROE	Return on Equity
SEOs	Seasoned Equity Offerings
STD	Short Term Debts
TA	Total Accruals
TR	Trade Receivables